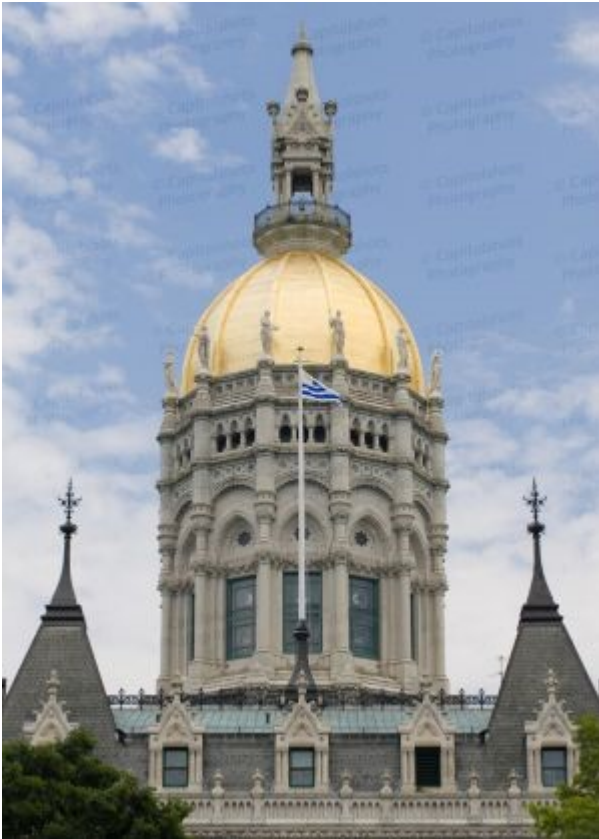


The Legacy Obligation Trust

A new approach to funding pension & OPEB liabilities



Connecticut Pension Sustainability Commission

September 21, 2018

Michael Imber – Eisner Amper LLP

- **Connecticut resident for 25 years**
- **Recovering banker**
- **Bankruptcy & turnaround consulting since 1993**
- **Focus on municipal distress since 2009**
- **Municipal / State distress consulting**
 - Nassau County, NY
 - State of Kansas
- **Chapter 9 experience**
 - Mammoth Lakes, California
 - Jefferson County, Alabama
 - City of Detroit, MI
- **Managing Director, EisnerAmper Public Sector Advisory Services**

Presentation Agenda

- 1) Legacy Obligation Trust (“LOT”) – Executive Summary**
- 2) Background on LOT concept development**
- 3) The LOT Model**
 - ☐ **Design**
 - ☐ **Examples**
 - ☐ **Who else has seen this?**
- 4) Benefits, Reforms, Working Groups**
- 5) Discussion**

Executive Summary

- **The Legacy Obligation Trust (“LOT”) concept is a new approach to solving the underfunded municipal pension and retiree healthcare problem in the United States.**
- A government unit makes an **in-kind contribution of real assets** – like land, buildings, infrastructure, enterprises
 - **to a professionally and independently managed trust**
 - **for the benefit of one or more underfunded municipal pensions and retiree health plans.**

Executive Summary

- The trust issues **Certificates of Trust (“COTs”)** as the means of conveying **ownership**
- COTs function like **shares of stock** if thousands or tens of thousands of units are issued, **permitting ownership division among more than one pension/OPEB fund**
- COTs are structured as **marketable securities**

Executive Summary

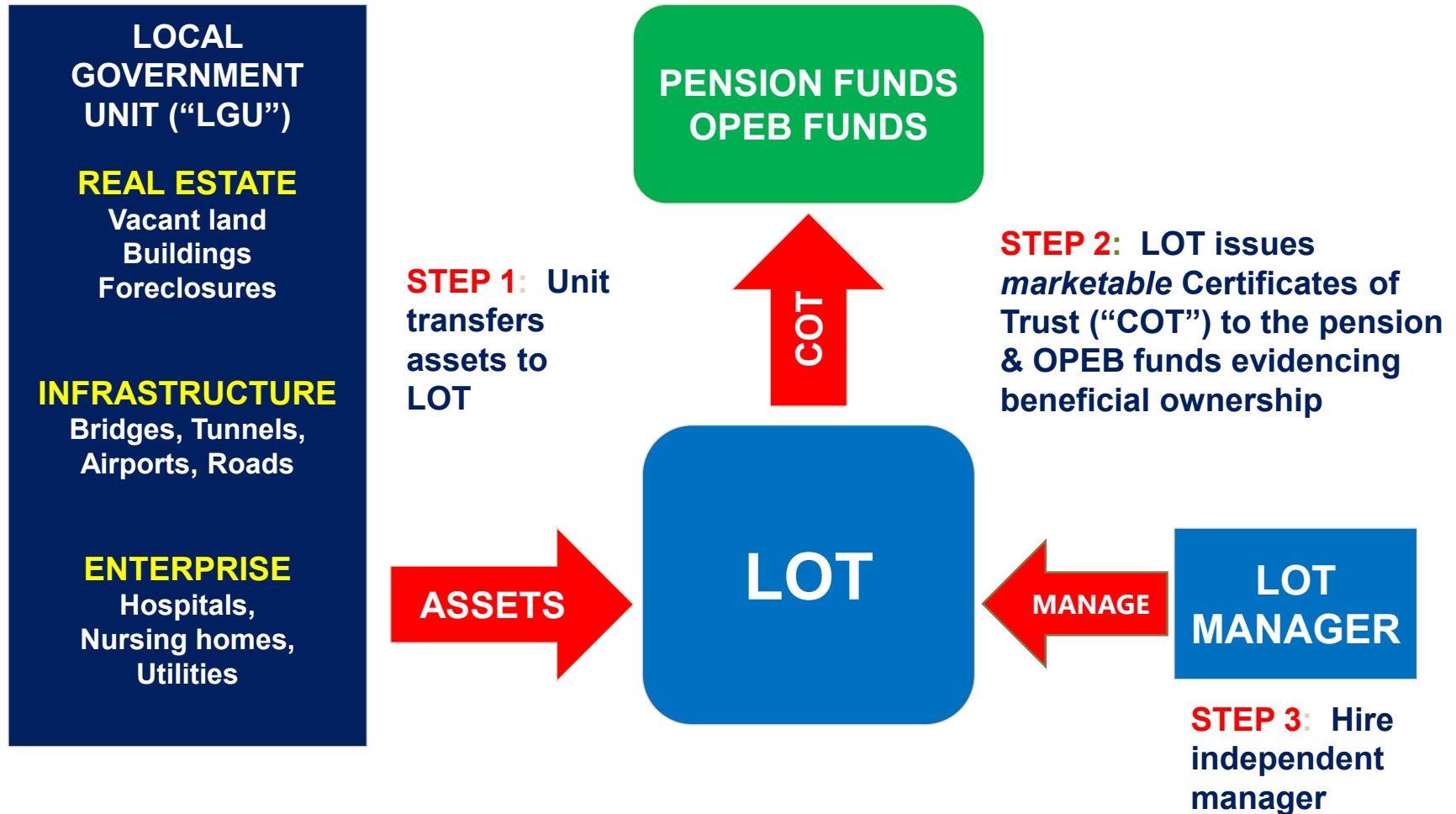
- The government unit's intended benefits include:
 - **an immediate credit against its unfunded liability based on the fair market valuation of the assets contributed to the trust**
 - the pension & OPEB funded ratios increase, which **may improve the credit rating agencies' assessment of the government unit**
 - **an immediate, positive cash flow impact on the unit's budget** as the "catch-up" payment for the underfunding goes down
 - the independent, **professional manager is incented to create additional value** to further increase the pension's funded ratio
- **The LOT concept is a new idea that has not been previously implemented in the U.S.**
- **In-kind contributions to pensions have been utilized in the U.S. and internationally.**

Background on LOT concept development

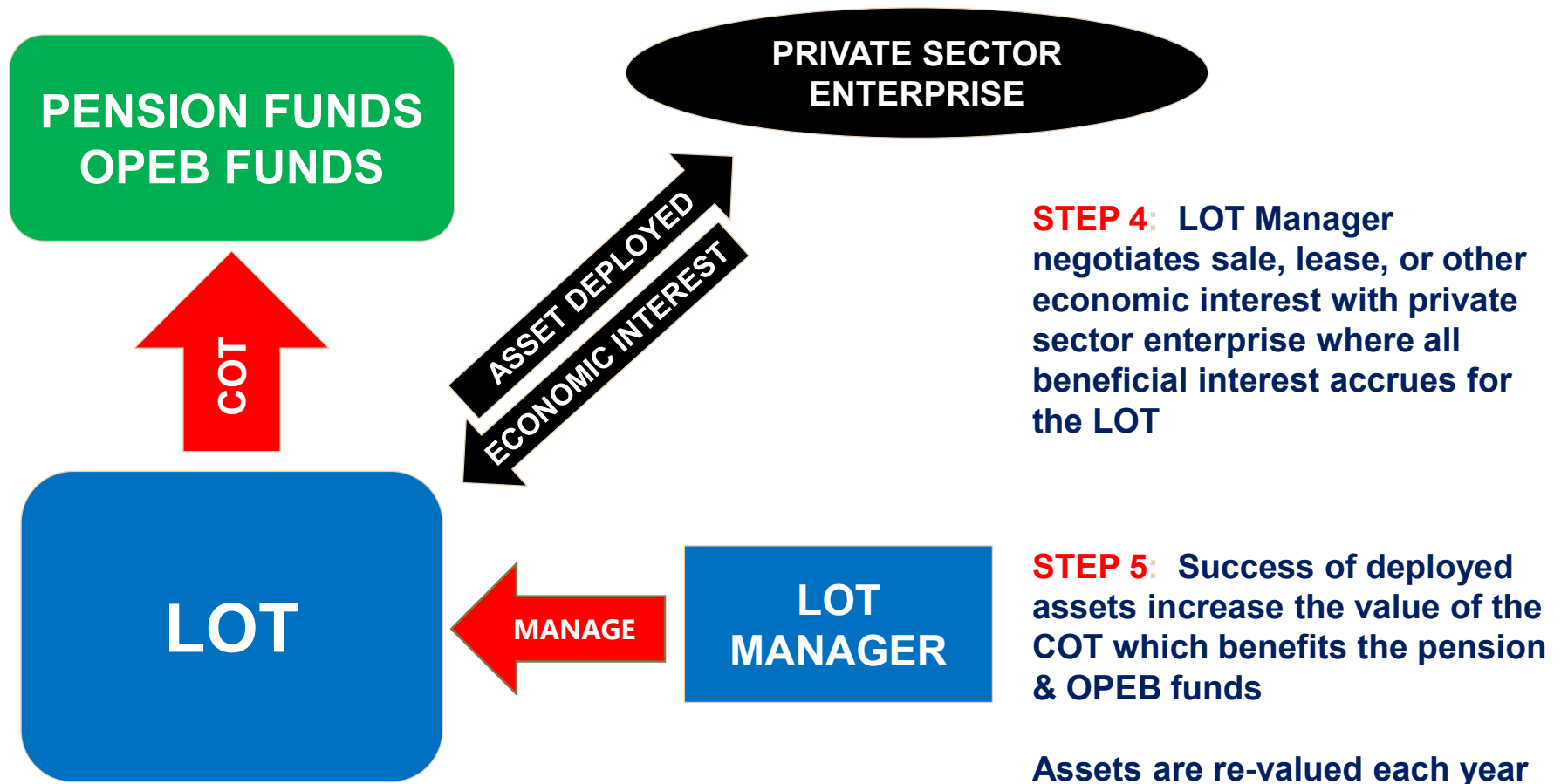
- **City of Detroit bankruptcy**
- **Certificate of Participation note holders**
 - **Financed \$1.4 billion pension contribution**
- **Offered recovery**
- **Final outcome**
- **Judge Rhodes' opinion on Plan of Adjustment**

An **alignment of interests** could be the path to fixing legacy obligations

Legacy Obligation Trust Model



The LOT Manager maximizes economic value



Further thoughts on Capital Asset Universe

- **Undeveloped assets** can be converted to cash generating, unlocking new value
- **Developed assets** need to be assessed for highest and best use and potential for profitable turnaround

UNDEVELOPED	DEVELOPED ENTERPRISE ASSETS	
No \$	Making \$	Losing \$
<ul style="list-style-type: none">• Raw Land• Government occupied buildings	<ul style="list-style-type: none">• Stadiums• Golf Courses• Utilities	<ul style="list-style-type: none">• Hospitals• Skilled Nursing Facilities

Connecticut Universe of Assets (*at cost*)

State of Connecticut's Capital Assets (Net of Depreciation, in Millions)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2017	2016	2017	2016	2017	2016
Land	\$ 1,788	\$ 1,747	\$ 69	\$ 68	\$ 1,857	1,815
Buildings	2,836	2,605	3,385	3,253	6,221	5,858
Improvements Other Than Buildings	127	141	197	184	324	325
Equipment	49	-	344	348	393	348
Infrastructure	5,096	4,613	-	-	5,096	4,613
Construction in Progress	4,988	4,545	877	686	5,865	5,231
Total	<u>\$ 14,884</u>	<u>\$ 13,651</u>	<u>\$ 4,872</u>	<u>\$ 4,539</u>	<u>\$ 19,756</u>	<u>\$ 18,190</u>

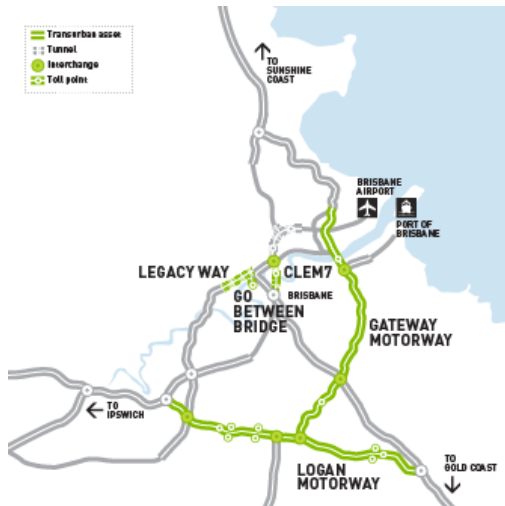
- **Total Primary and Enterprise Capital Assets \$19.8 billion**
- **Total Component Unit Capital Assets \$771 million**
- **Total Universe \$20.5 billion**
 - *This figure does NOT represent fair market value*

all figures net of depreciation

Examples

Queensland Motorways

Queensland, Australia



Batterson Park

Hartford, CT



Who else has seen this?

- **Rating agencies**
- **Universities**

Aligned incentives make the “gears” turn

Labor and management become partners for economic growth

- **PENSIONS & OPEB:**

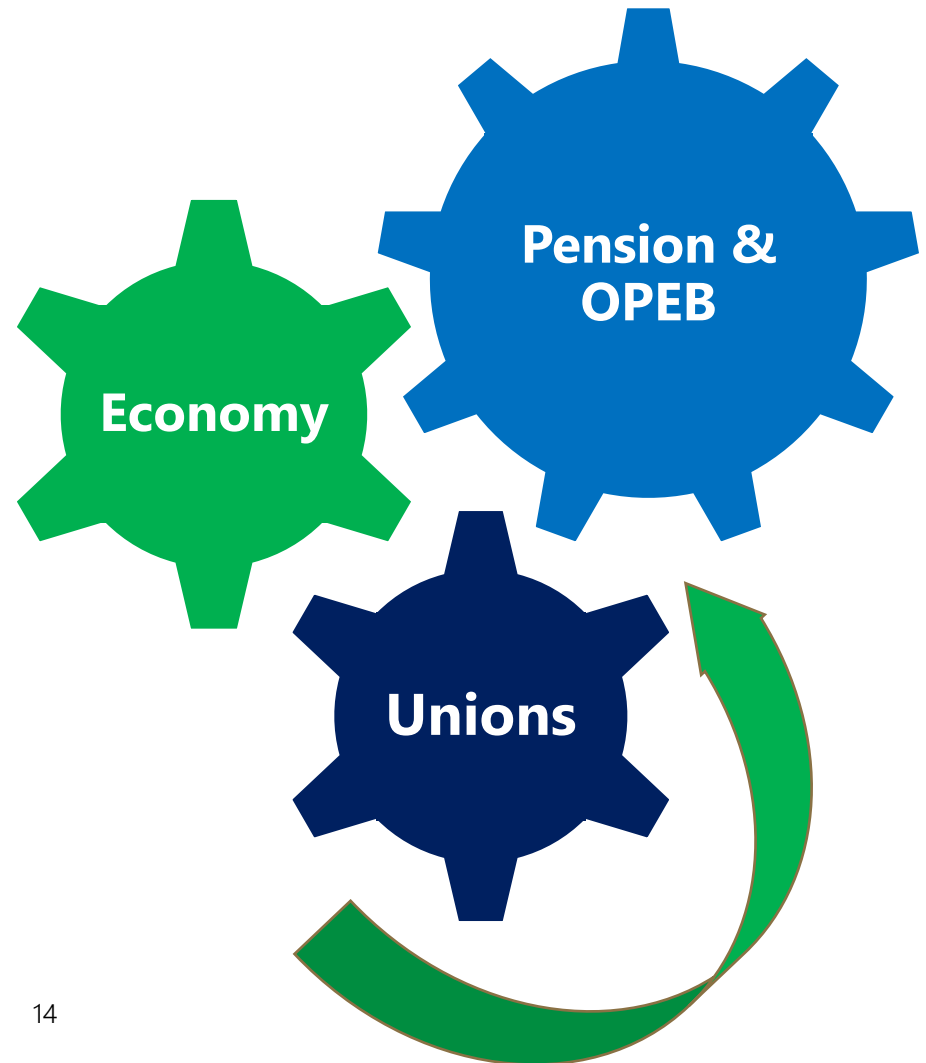
- Funding ratios increased immediately
- Retirees share in upside
- Marketable COT enhances valuation

- **UNIONS:**

- Current employee interests align with economy

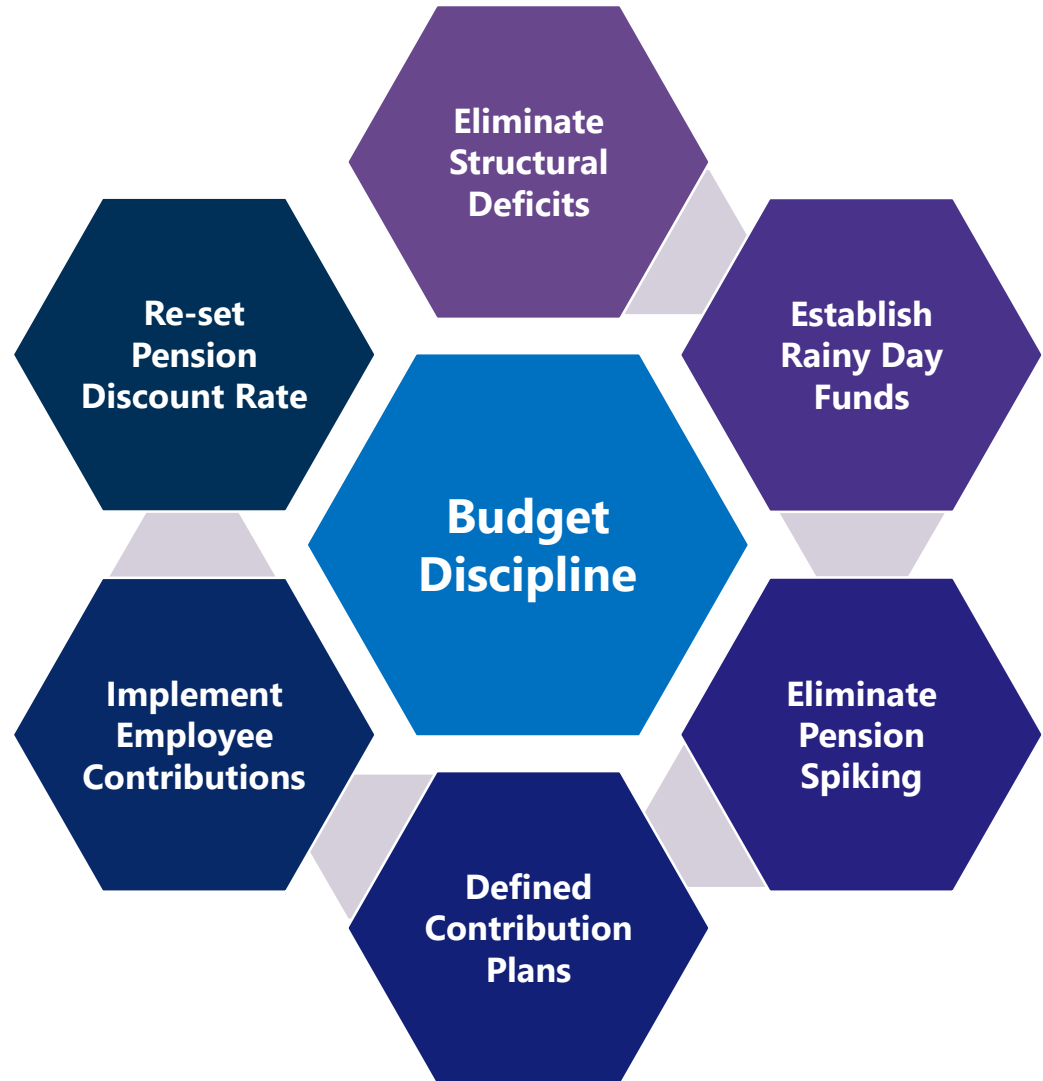
- **ECONOMY:**

- Stimulate new jobs and incents government to create growth environment
- Enhance neighborhoods
- Generate new tax revenue



A sustainable solution requires other reforms...

- The LOT concept cannot be assumed to be the only reform necessary to effect sustainable change
- LOT implementation must be met with the fiscal discipline to adopt best practices in budget management
- Without other reforms, the bad habits of the past can create the legacy obligation funding problem again in the future



CT PSC Working Groups

Capital Asset Selection

- Selection criteria
- Potential alternative uses
- Opportunity Zone / Enterprise Zone

Economic Development

- Industry initiatives
- Potential regulatory reform
- Potential tax reform

Legal

- Legislative considerations for asset contribution
- COT design considerations / Treasury acceptance
- Trust governance and design

Accounting / Actuarial

- Confirmation of accounting/actuarial treatment
- GASB Perspectives
- Rating Agency reactions

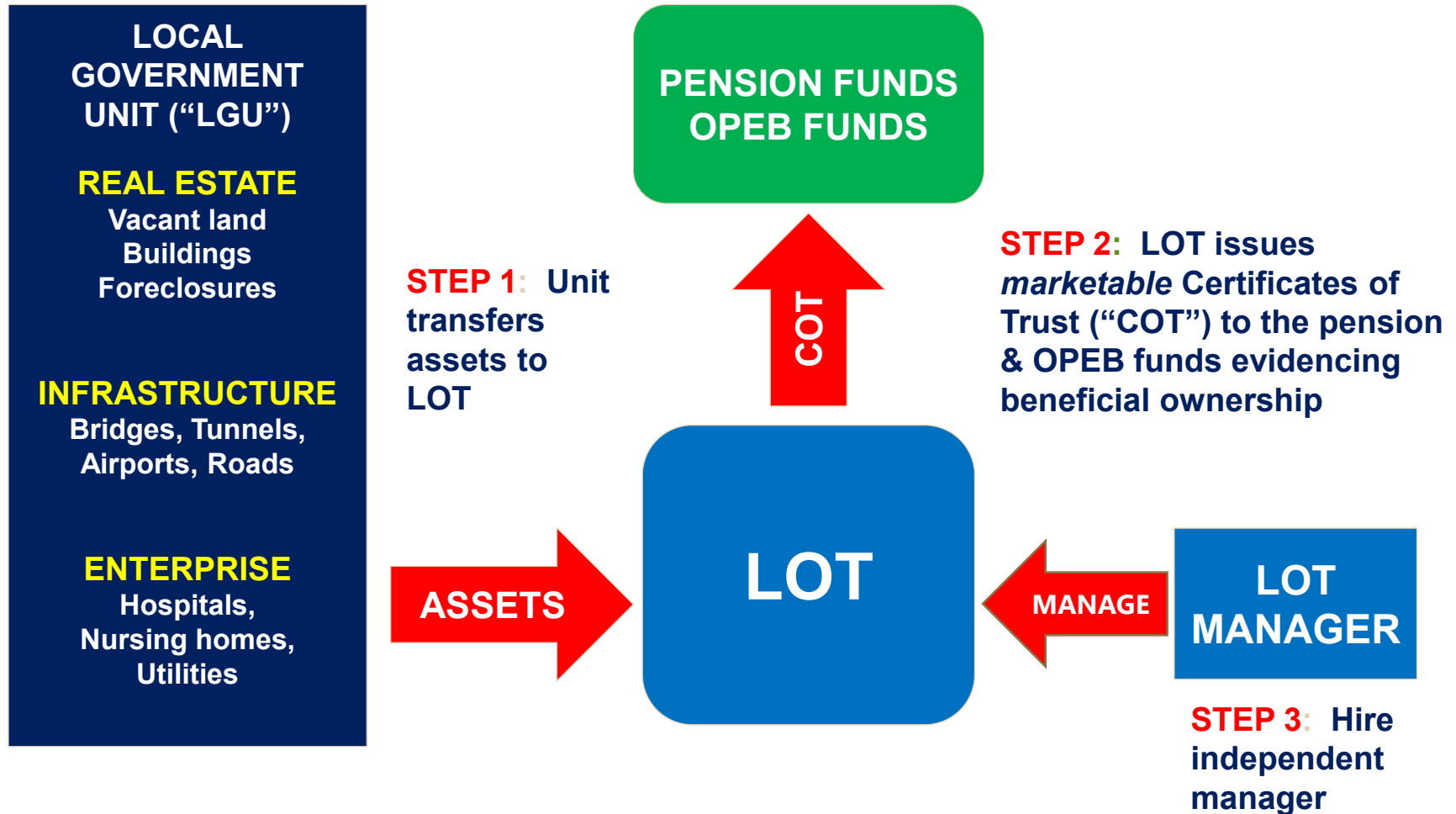


Appendix A

Detailed Description of the Legacy Obligation Trust model



Legacy Obligation Trust Model



STEP 1 – LGU Transfers Assets to the LOT

LGU identifies universe of potential assets for an in-kind contribution

- What are the assets that government does **not** need to own?
 - Real estate, infrastructure, enterprises
 - Governments often hold assets to maximize political, not economic, utility
 - Such assets hold **unrealized equity value** that, if professionally managed, could be unlocked to increase actual value and drive economic growth.
 - Examples might include:
 - Raw land to be developed into alternative commercial use
 - State offices are consolidated to empty entire buildings that could be leased or sold to the private sector
- **The value of the in-kind contributed assets provide immediate credit to the pension and OPEB funds**
 - Valuation methodology needs to be commercially reasonable
 - LOT assets must be re-valued each year

STEP 2 - LOT Issues Certificate of Trust

Pension & OPEB funds will own and hold Certificates of Trust ("COTs")

- The COTs serve as evidence of ownership of the LOT
- A large number of COTs may be issued to accommodate a division of ownership between multiple pension and OPEB funds
- **The COTs' value is based on the desk-top valuation of the assets at time of contribution and annually thereafter**
- The COTs could be structured as marketable securities
 - If the LOT assets generate steady cash dividends, the COTs may become an attractive investment opportunity for third-party money managers
 - ❑ Such a secondary market gives the pension & OPEB funds a liquidation option without forcing the sale of the assets from the LOT
 - A secondary market for COTs eliminates the need for an annual desk-top valuation
 - ❑ The COT market price becomes a proxy measure of the economic fortunes of the government that has contributed the assets

STEP 3 – Government hires LOT Manager

The LOT Manager is incentivized to maximize economic utility of trust assets

- The **assets contributed** to the LOT **dictate the skill set** of the manager to be hired
- The LOT Manager must be **independent, authorized, and empowered**
 - The LOT Manager is **not** subject to government control or influence
 - The LOT Manager is authorized and empowered to sell, lease, or contribute the assets to joint ventures
 - **The integrity and professionalism of the LOT Manager is critical to success**

STEPS 4 and 5 – LOT Manager

The LOT Manager is incentivized to maximize economic utility of trust assets

- The LOT Manager's authority and governance structure must be well defined in advance
 - Protocols for transparency must be established
 - Auction protocols must be defined
- A Board of Trustees provides oversight on the LOT Manager
 - Board members will include representatives of the beneficiary pension & OPEB funds, members of the business community, and labor
- New value creation is the LOT Manager's measure of success
 - Growing LOT asset value further offsets unfunded pension liability, minimizes "catch-up" payments, and stimulates the economy
 - Granting a share of the COTs to the LOT Manager aligns incentives